No. 86-875

(3)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

ARTHUR ANDERSEN & CO.,

Petitioner,

—v.—

MANUFACTURERS HANOVER TRUST COMPANY,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF OF PETITIONER ARTHUR ANDERSEN & CO.

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Petitioner Arthur Andersen & Co. ("Andersen")[1] submits this brief in response to points raised in the Brief in Opposition filed by Respondent Manufacturers Hanover Trust Company ("MHT") on December 24, 1986 ("MHT Br.").

1 Andersen is a general partnership, not a corporation; Rule 28.1 does not apply.

I.

Andersen Did Not Waive Its Challenges to the Legal Significance of the Post-Verdict Inquiry.

Andersen's silence when the trial court made its post-verdict inquiry was not a waiver of Andersen's right to challenge the court of appeals' use of that inquiry to create a separate "10B5" verdict.

The trial was concluded when the jury returned the general verdict that the trial court had instructed it to return. A50-A52.[2] Further inquiry of the jury was without legal significance. Pet. 6-11.

Since Andersen's challenge is to the legal significance of the post-verdict inquiry—not to the language of the inquiry itself or to any other matter that could have been cured had objection been made at the time of the inquiry—the proper time to raise Andersen's challenge was when MHT first suggested to the trial court that the judgment should reflect separate verdicts on MHT's respective claims. Andersen promptly did so, leading the trial court to enter a judgment reflecting the jury's general verdict. A42-A43. MHT's claim of waiver is therefore spurious.

The cases MHT cites in support of its waiver claim are not even remotely on point. They all involve a collateral attack on a judgment affirmed on direct appeal. *See Smith v. Murray*, 106 S. Ct. 2661 (1986) (waiver by deliberate decision not to raise issue on direct appeal); *Engle v. Isaac*, 456 U.S. 107 (1982) (waiver by not objecting to erroneous jury instruction despite Ohio criminal rule requiring objection before jury retires); *Wainwright v. Sykes*, 433 U.S. 72 (1977) (waiver by not making a motion to suppress before trial despite Florida criminal rule requiring timely motion).

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2 "A" refers to the Appendix to the Petition. "Pet." refers to the Petition.

II.

The Court of Appeals' Refusal to Review Each of MHT's Three Theories of "10B5" Liability Was Contrary to This Court's Decisions.

The court of appeals' assumption that the jury found a "primary" violation of Section 10(b), and its refusal to review the other two theories of Section 10(b) liability that were submitted to the jury (aiding and abetting and conspiracy), was directly contrary to the appellate procedure mandated by the decisions of this Court. *See* Pet. 11-13. MHT does not even attempt to defend the court of appeals' use of *Turner v. United States*, 396 U.S. 398, 420-21 (1970), to negate the clear holding of *Greenbelt Cooperative Publishing Ass'n v. Bresler*, 398 U.S. 6, 11 (1970), decided later in the same term.

MHT instead misleadingly suggests that its "waiver" arguments apply to the court of appeals' refusal to review the alternative bases of Section 10(b) liability. MHT Br. 3-4. But the court of appeals never held, and could not have held, that Andersen waived its challenge on this issue. The court of appeals just refused, without explanation, to review each of MHT's three theories of Section 10(b) liability, A32, A38, though Andersen clearly delineated the court's duty to do so in Andersen's initial briefs and in its Petition for Rehearing.

Andersen had no duty to ask for further clarification of the jury foreman's statement that "10B5" had been violated,[3] as MHT suggests. MHT Br. 3. Andersen preserved its objections to the legal sufficiency of MHT's aiding and abetting and

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3 The jury foreman gave no indication of which of MHT's three theories of "10B5" liability formed the basis of his statement. A53. To the extent the court of appeals interpreted the jury foreman's statement as a finding of a "primary" violation, the court was subject to the very same criticism that it leveled at other suggested interpretations of the foreman's response: "[t]he integrity of the jury system and the concern for fairness to litigants simply cannot accommodate such guesswork in sustaining a verdict." A32.

conspiracy claims by objecting to the court's instructions. It had no responsibility to request separate verdicts on each of these theories of Section 10(b) liability. This Court has consistently overturned general verdicts where one of the underlying claims is legally deficient, Pet. 12, without requiring the party challenging the general verdict to ask for separate verdicts in order to preserve its objections.

Moreover, MHT had the same opportunity to clarify the jury foreman's "10B5" response as did Andersen. MHT seeks to use the post-verdict questioning to elicit a separately-sustainable jury finding of a "primary" violation of Section 10(b). MHT, not Andersen, should bear the risk of failure to obtain clarification of the jury's response.

III.

Andersen Was Entitled to a Jury Determination, After Proper Instructions, Whether Its Alleged Fraud Was "In Connection With" the Purchase or Sale of Securities.

The entire thrust of MHT's argument in Point II of its brief, MHT Br. 4-7, is that a properly-instructed jury could have concluded that Andersen's alleged fraud was "in connection with" the purchase and sale of securities. This misses the point. The jury was not given proper instructions on this issue, and Andersen's alleged fraud was not *necessarily* "in connection with" MHT's purchase or sale of government bonds, as the court of appeals wrongly held. The effect of the court of appeals' decision was to deprive Andersen of its right to a jury determination of this issue, which was crucial to federal court jurisdiction over this case.

The jury was told that repos are themselves "securities" and that "you can take this element as established as to each of the federal causes of action." A54. It was not given any guidance as to the meaning of the "in connection with" requirement and was never asked to consider whether the alleged fraud was "in connection with" bonds that MHT purchased and sold.

If the issue had been submitted to it, the jury reasonably could have concluded that Andersen's alleged fraud was not "in connection with" MHT's purchase and sale of bonds. MHT alleged that "but for" Andersen's report MHT's credit department would not have allowed MHT's Securities Lending Department to continue doing business with Drysdale. A55. Under similar circumstances district courts have even dismissed claims for lack of sufficient causation. *See, e.g., Bochicchio v. Smith Barney, Harris Upham & Co.*, 85 Civ. 6544 (PKL) (S.D.N.Y. Nov. 18, 1986; available on Lexis) (misrepresentations of brokerage firm account representative that induced plaintiff to open an investment account did not pertain to any securities traded in that account); *First Federal Savings & Loan Ass'n v. Oppenheim, Appel, Dixon & Co.*, 629 F. Supp. 427, 441-42 (S.D.N.Y. 1986) (alleged fraudulent misrepresentations by accountants concerning the financial condition of a government securities dealer did not proximately cause plaintiffs' losses although they allegedly caused plaintiffs to purchase the securities that led to their losses).

The court of appeals attempted to brush aside the absence of a jury finding on this important issue by holding that a repo is a "contract" to buy or sell securities and that any fraud "in connection with" such a contract is necessarily fraud "in connection with" the purchase or sale of the underlying securities. But it is plainly too broad to hold that any fraud affecting a contract is *necessarily* fraud in connection with a securities transaction that may be part of the contract.[4] This holding is

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4 *SEC v. Drysdale Securities Corp.*, 785 F.2d 38 (2d Cir.), *cert. denied*, 106 S.Ct. 2894 (1986) does not support this far-reaching determination. Pet. 15-16. Neither does H.R. Rep. No. 258, 99th Cong., 1st Sess. 17 n. 22 (1985), quoted at MHT Br. 5-6, which merely predicted the court of appeals' reversal of the district court decision in *SEC v. Drysdale*. Nor did the SEC itself urge this determination, as suggested by MHT. MHT Br. 7. The very authorities there cited, Securities Act Release No. 33-6351 and the SEC's amicus brief below, emphasize that the application of the antifraud provisions of the federal securities laws "depends on the facts and circumstances surrounding each individual transaction." 1 Fed. Sec. L. Rep. (CCH) ¶ 2024, at 2559-3 (Sept. 25, 1981); *see* SEC Amicus Brief at 7 n. 12 (April 1986).

not in accord with "settled principles," MHT Br. 4, and such rulings do violence to settled principles by extending the reach of the federal securities laws to claims that properly belong in state courts.[5]

The "in connection with" requirement focuses on securities transactions themselves, and not on general relationships of which securities transactions may be a part. The court of appeals simply went too far in holding that any fraud affecting MHT's repo business with Drysdale (such as the alleged "door opening" effect of MHT's credit department's reliance on Andersen's report) was *necessarily* fraud "in connection with" the hundreds of individual bond transactions into which MHT entered. The proper meaning of the "in connection with" requirement requires clarification by this Court, Pet. 13-16, and the Court should issue a writ of certiorari to provide that clarification in this case.

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5 *Technology Exchange Corp. of America v. Grant County State Bank*, 646 F. Supp. 179 (D. Colo. 1986), is a recent example of such a ruling. There, the court held that a fraud that induced plaintiff to enter into a contract to manage property was actionable under § 10(b) and Rule 10b-5 because a stock bonus was contingent compensation under the contract. The court reasoned that "Section 10 is designed to remedy all situations where fraudulent practices have been used in the connection with the purchase or sale of securities regardless of the actual terms of the purchase or sale." 646 F.Supp. at 182.

CONCLUSION

For the foregoing reasons and those stated in the Petition, a writ of certiorari should issue to review the judgment and opinion of the Court of Appeals for the Second Circuit.

Respectfully submitted,

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